

STATE OF IOWA
PROPERTY ASSESSMENT APPEAL BOARD

23rd Street Hotel Associates,
Petitioner-Appellant,

v.

Pottawattamie County Board of Review,
Respondent-Appellee.

ORDER

Docket No. 11-78-0246
Parcel No. 7444-03-400-014

On August 8, 2012, the above captioned appeal came on for hearing before the Property Assessment Appeal Board. The appeal was conducted under Iowa Code section 441.37A(2) and Iowa Administrative Code rules 701-71.21(1) et al. Deborah Tharnish of Davis, Brown, Koehn, Shors, & Roberts, PC, Des Moines represented the Appellant, 23rd Street Hotel Associates. Assistant County Attorney Leanne A. Gifford represented the Pottawattamie County Board of Review. The Appeal Board having reviewed the record, heard the testimony, and being fully advised, finds:

Findings of Fact

23rd Street Hotel Associates (23rd Street) is the owner of a commercially classified hotel building located at 2702 Mid America Drive, Council Bluffs, Iowa. It appeals from the Pottawattamie County Board of Review decision reassessing its property. The real estate was classified commercial for the January 1, 2011, assessment, and valued at \$14,000,000;¹ representing \$385,000 in land value and \$13,615,000 in improvement value. 23rd Street protested to the Board of Review on the ground the property's assessment was not equitable with the assessments of other like property under Iowa Code section 441.37(1)(a); and the property was assessed for more than authorized by law under section 441.37(1)(b). The Board of Review denied the protest.

¹ 23rd Street previously protested their 2010 assessment to this Board in Docket No. 10-78-0272. The 2010 assessment was also \$14,000,000. This Board's Order modified the assessment to \$8,420,000. This Order was issued after the 2011 assessment date.

23rd Street then appealed to this Board asserting the same grounds. On its appeal form, 23rd Street asserted the correct assessment is \$9,119,205. However, it now seeks an assessed value of \$8,620,000 based on an appraisal of the subject property, which excludes the land lease payments and furniture, fixtures, and equipment (FF&E). At hearing, 23rd Street stated their main assertion was that of over-assessment. Scant evidence and testimony was presented regarding an equity argument, as such we will only consider a claim of over-assessed.

The subject property, locally known as the Hilton Garden Inn, is adjacent and connected to the Horseshoe Casino. The improvements and additional parking are located on land leased from HBR Realty Company, which is also the owner of the adjacent casino. The lease has a term of forty-eight years. The land area covers the 38,768 square-foot area under the hotel and an additional parcel consisting of 400 parking spaces, which are 105 square feet each.

The subject property is a five-story, steel-frame building with EIFS exterior, built in 2009. It has 153 rooms, including 32 suites. Common areas include a reception area, lobby, restaurant with bar, office area, meeting rooms, and a pool.

Bruce Kinseth, owner/operator of 23rd Street, testified at hearing regarding the property's assessment. Kinseth has been in the hotel/hospitality business for approximately thirty years. His corporation currently has an interest in just over thirty properties, while managing around 100 properties, all located primarily in the upper Midwest. He testified regarding the economic condition of the hotel industry in the last few years, as well as to management fees and the average daily rate (ADR), which are factors considered in the income approach to value.

Kinseth stated when the decision was made to build there was an agreement with the Casino to rent up to half of the rooms for about \$90 per room. However, since construction, the market decline coupled with other direct competition in the area resulted in a lack of enforcement of the agreement. He

reports the hotel receives room rental rates anywhere from \$49-\$69 per night from the casino, with most of the rates at \$69 per night; and that the casino buys roughly one third of the total rooms sold.²

Kinseth explained that the ADR is a blend of every room rate that is actually rented and may or may not include items such as a breakfast or free bottled water in the room. Kinseth also took exception with the Board of Review's appraisal, in which the appraiser determined an ADR of \$92.50. He believed this rate was too high because it is not reflective of the actual ADR. He reports the subject property had actual ADRs of \$85.40. We note that a Smith Travel Research (STAR) report submitted by 23rd Street indicates an ADR of \$87.70 for the subject property, which is slightly higher than what Kinseth reports, but still lower than that offered by the Board of Review's appraiser.

Although Kinseth saw a decline in the market in 2009, he testified that the market "in 2012 has improved over 2011." However, we note the improvement he has observed is after the effective date on appeal. Kinseth also stated that due to competition from the Casino and other nearby dining establishments, 23rd Street had applied to Hilton to close the restaurant for dinner based on poor performance for that meal service. Hilton denied the request and based its denial on an effort to maintain brand integrity and uniformity. Kinseth believes the Board of Review's appraiser did not adequately consider the poor performance of the restaurant in his analysis.

We find Kinseth to be a knowledgeable participant and observer of the hotel industry. He provided credible insight regarding 23rd Street's operations, including testimony regarding capitalization rates and net operating income (NOI). Ultimately, however, he did not provide a market value opinion of the subject as of January 1, 2011.

Both 23rd Street and the Board of Review submitted appraisals in support of their positions.

23rd Street submitted an appraisal prepared by Tom Dowhan and Ted Frandson with Frandson and Associates, L.C., Des Moines, Iowa. Ted Frandson testified on 23rd Street's behalf. Frandson's

² This percentage is based on occupancy, not 100% of total room count.

appraisal of the subject property, which had an effective date of January 1, 2011, developed all three approaches to value. His conclusions for each approach, including furniture, fixtures, and equipment (FF&E), are as follows:

Cost Approach	\$11,809,000
Sales Comparison Approach	\$ 9,945,000
Income Approach	\$ 9,475,000

He concluded a final opinion of value of \$9,700,000 including the FF&E, which totaled \$1,080,000. His final opinion of value for the real property only was \$8,620,000.

Frandsen completed the cost approach, but gave it the least consideration in his reconciliation of value. His reason for giving it the least consideration was due to the property's external obsolescence. Frandsen considered three land sales to determine a \$14.00 value per square foot for the subject property's land. In determining the cost of improvements, Frandsen used *Marshall and Swift Valuation Service*. He determined an effective age of twenty-one years for the subject property, which has an actual age of two years. He also applied 42% depreciation to the improvements. Frandsen's appraisal stated this was due to obsolescence because, in his opinion, the ADR and operating expenses do not justify the construction cost of the improvements. Yet, he also notes the improvements do contribute to the value and income producing capability of the site. We note that Frandsen did not offer any support or evidence for this amount of depreciation in the form of an age/life analysis, or explain how he concluded an effective age of twenty-one years. If the economic obsolescence existed to this large of extent, it would seem prudent to isolate it by another method. However, we do not find this issue of much importance to the reliability of the appraisal as a whole because Frandsen ultimately gave the cost approach minimal consideration in his reconciliation of value.

Frandsen's sales comparison approach considered three comparable properties. The appraisal notes there was a limited amount of sales of full service hotels. Two sales were located in Omaha,

Nebraska and one in Bellevue, Nebraska. Frandson acknowledged the Bellevue property was a 1031 exchange; however, he did not consider this an abnormal sale. We note this sale set the lower end of the range before and after adjustments. Therefore, compared to the other sales he considered, it seems the market reacted differently to this transaction. All three properties sold in 2008. The adjusted price per unit ranged from \$61,958 to \$72,250, which includes the land and FF&E. From this range, Frandson concluded a price per unit of \$65,000. This value was approximately in the middle of the range of sales, and we find it reasonable even considering Frandson's use of the Bellevue sale because it is supported by the other two sales.

Lastly, Frandson developed the income approach to value. Frandson considered the market rates of seven other properties in the subject's area. He estimated an ADR of \$90 per night based on performance for the subject property for the past twelve months. He also considered a 4% management fee to arrive at a net operating income (NOI) of \$1,231,767. Frandson testified that he considered the actual expenses, which he found were consistent with market data expenses. He then applied a 12.99% loaded capitalization (cap) rate to this figure to arrive at an income approach value of \$9,475,000.

Frandson arrived at a final reconciled value of \$9,700,000 (including FF&E), giving most weight to the sales approach and income approach to value. He then subtracted \$1,080,000 for non-taxable property, and concluded a total value of the real property at \$8,620,000.

Overall, we find Frandson to be a credible and knowledgeable witness and his conclusions to be reasonable and supported.

Michael Olson, with the Olson Group, Urbandale, Iowa, completed an appraisal for the Board of Review with an effective date of January 1, 2011. Like Frandson, Olson developed all three approaches to value. Olson considered the income approach the most reliable indicator of value, with the sales and

cost approaches serving as a check. His conclusions for each approach, *excluding* Furniture, Fixtures, and Equipment (FF&E), are as follows:

Cost Approach	\$14,700,000
Sales Comparison Approach	\$13,000,000
Income Approach	\$11,770,000

He concluded a final opinion of value of \$12,200,000 for the real property only.

Olson considered four land sales to determine a \$10.00 value per square foot for the subject property's land. Olson also used *Marshall and Swift's Valuation Service* cost handbook for his cost approach. He concludes a total cost new for the building of \$13,398,628.80, and a total cost new (including site improvements, landscaping and indirect costs) of \$14,298,628.80. His final total cost new less depreciation, after the site value was included, was \$14,700,000. Olson also reports that information provided by the client indicated original construction costs to be roughly \$15,600,000, excluding FF&E and land. He asserts this lends additional support to his replacement costs. We agree. However, we take exception with the fact that Olson does not depreciate the cost approach. He contends there is no functional or external obsolescence, and because the improvements are newer (built 2009), there has been "no noticeable or significant physical depreciation." While we believe Frandson's use of 42% depreciation is high, we equally believe Olson's belief that the subject property has experienced no depreciation is unreasonable. However, we again note both appraisers give limited consideration to this approach, and therefore, we will not give it greater consideration.

Olson considered three comparable properties in his sales comparison approach. All three sold in 2008 and are located in Omaha. Two of the properties: 17606 Arbor Plaza and 17677 Wright Street were also used by Frandson. Olson's third comparable property, 330 N 30th Street, is an older property (built in 1985) that required significant age and quality adjustments. As such, we would give this comparable limited consideration. Considering all three properties, Olson's adjusted price per room

ranges from \$74,427 to \$87,389. He selected an opinion of \$85,000 per room. His final value opinion is \$13,000,000.

The primary difference between Olson and Frandson's sales comparison analysis, considering only the Arbor Place and Wright Street sales, is the market conditions adjustments for time. Frandson made a downward 15% adjustment to both sales, whereas Olson made a downward 5% adjustment to Arbor Place and a downward 10% adjustment to Wright Street. In this instance, based on the testimony from all witnesses, we believe that the hotel industry experienced a negative impact that is better reflected by Frandson's adjustments.

Lastly, Olson developed the income approach. Similar to Frandson, Olson determined a 12.8% capitalization rate, and they had near identical opinions regarding FF&E. The four main areas of difference between Olson and Frandson's income approach are the parking, reserves for replacement, franchise fees, and management fees. These differences are as follows:

	<u>Olson</u>	<u>Frandson</u>
Parking	\$55,000	\$90,000
Reserves	2%	4%
Franchise Fees	\$400,000	\$475,000
Management Fees	3%	4%

The Board of Review also submitted a third appraisal. It was completed by Gene F. Nelsen and Ranney Ramsey of Nelsen Appraisal Associates, Inc. Neither Nelsen nor Ramsey testified. The appraisal concluded an "as is" value of \$10,450,000 as of January 1, 2010, and an "as stabilized" value of \$11,000,000, as of January 1, 2013. Because there was no testimony regarding this appraisal and because the "as is" or "as stabilized" value opinions are not reflective of the January 1, 2011, assessment date that is the subject of this appeal, we give it no consideration.

After hearing testimony from all witnesses, we give more weight to Frandson's opinions and believe they are the most credibly supported. They also appear most consistent with market actions and

data. Additionally, we note that Frandson gave most consideration to the sales comparison approach, which is the preferred method for assessment of real property.

23rd Street also called Pottawattamie Assessor Bill Kealy. Kealy's testimony was limited and did not provide any additional insight to the market value of the subject property.

Based on the foregoing, we find a preponderance of the evidence demonstrates the subject property is over-assessed.

Conclusions of Law

The Appeal Board applied the following law.

The Appeal Board has jurisdiction of this matter under Iowa Code sections 421.1A and 441.37A (2011). This Board is an agency and the provisions of the Administrative Procedure Act apply to it. Iowa Code § 17A.2(1). This appeal is a contested case. § 441.37A(1)(b). The Appeal Board determines anew all questions arising before the Board of Review related to the liability of the property to assessment or the assessed amount. § 441.37A(3)(a). The Appeal Board considers only those grounds presented to or considered by the Board of Review. § 441.37A(1)(b). But new or additional evidence may be introduced. *Id.* The Appeal Board considers the record as a whole and all of the evidence regardless of who introduced it. § 441.37A(3)(a); *see also Hy-vee, Inc. v. Employment Appeal Bd.*, 710 N.W.2d 1, 3 (Iowa 2005). There is no presumption that the assessed value is correct. § 441.37A(3)(a).

In Iowa, property is to be valued at its actual value. Iowa Code § 441.21(1)(a). Actual value is the property's fair and reasonable market value. *Id.* "Market value" essentially is defined as the value established in an arm's-length sale of the property. § 441.21(1)(b). Sale prices of the property or comparable properties in normal transactions are to be considered in arriving at market value. *Id.* If

sales are not available, “other factors” may be considered in arriving at market value. § 441.21(2). The assessed value of the property “shall be one hundred percent of its actual value.” § 441.21(1)(a).

There is statutory preference for establishing market values using sales of comparable properties. *Soifer v. Floyd County Board of Review*, 759 N.W.2d 775, 779 (Iowa 2009). The issue of comparability has two facets: the property must be comparable and the sale of that property must be a “normal transaction. *Id.* at 782-83. When sales of other properties are offered, they must be adjusted for differences that affect market value. *Id.* at 783. These differences could include size, age, use, condition, and location, among others. *Id.*

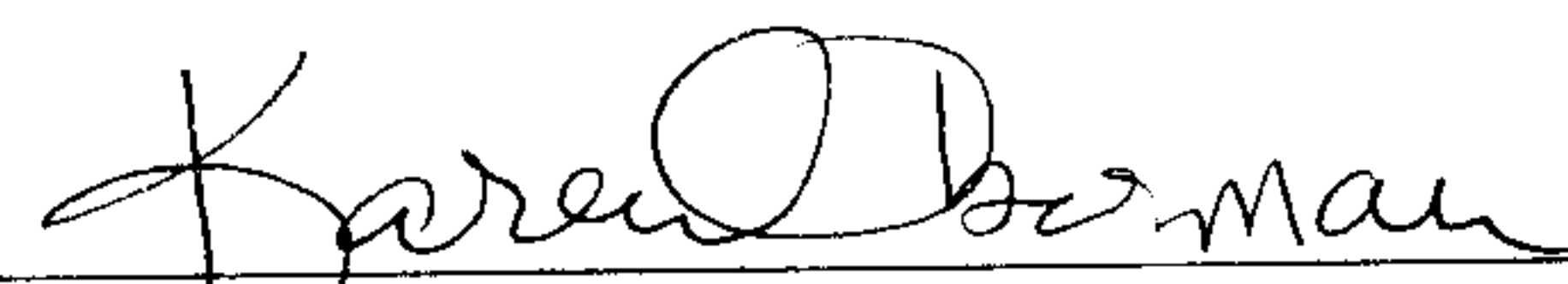
In an appeal that alleges the property is assessed for more than the value authorized by law under Iowa Code section 441.37(1)(b), there must be evidence that the assessment is excessive and the correct value of the property. *Boekeloo v. Bd. of Review of the City of Clinton*, 529 N.W.2d 275, 277 (Iowa 1995). Both parties provided a complete appraisal of the subject property. Although the reports consider similar sales and develop all three approaches to value, there is discrepancy in a few adjustments and key points of analysis, which result in different conclusions. Ultimately, we find Frandson's report to be the most credible and reliable evidence for the reasons set forth herein.

We find the preponderance of the evidence supports 23rd Street's claim of over-assessment.

THE APPEAL BOARD ORDERS the assessment of 23rd Street Hotel Associates property located at 2702 Mid America Drive, Council Bluffs, Iowa, be modified to a total value of \$8,620,000, as of January 1, 2011.

The Secretary of the State of Iowa Property Assessment Appeal Board shall mail a copy of this Order to the Pottawattamie County Auditor and all tax records, assessment books and other records pertaining to the assessments referenced herein on the subject parcels shall be corrected accordingly.

Dated this 18 day of September, 2012.


Karen Oberman, Presiding Officer


Richard Stradley, Board Chair

Cc:

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Certificate of Service	
The undersigned certifies that the foregoing instrument was served upon all parties to the above cause & to each of the attorney(s) of record herein at their respective addresses disclosed on the pleadings on <u>9-18</u> , 2012	
By:	<input checked="" type="checkbox"/> U.S. Mail <input type="checkbox"/> FAX
	<input type="checkbox"/> Hand Delivered <input type="checkbox"/> Overnight Courier
	<input type="checkbox"/> Certified Mail <input type="checkbox"/> Other
Signature	